

BEFORE THE

## Federal Communications Commission

WASHINGTON, D.C.

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )  
Simplification of the )  
Depreciation Represcription )  
Process )

CC Docket No. 92-296

REPLY COMMENTS OF THE  
INTERNATIONAL COMMUNICATIONS ASSOCIATION

The International Communications Association (ICA) hereby submits its Reply Comments in response to the Notice of Proposed Rulemaking in this proceeding [8 FCC Rcd 146 (1992)].

The ICA is the largest association of telecommunications users in the world. ICA has over 720 members who spend at least \$1 million per year upon acquisitions of equipment and services. Both because of its growing membership and their increasing reliance on public telecommunications, ICA members' estimated expenditures on telecommunications are growing rapidly. Recent estimates indicate that ICA members spend over \$21-billion on telecommunications services and equipment. The vast bulk of this money is paid, directly or indirectly, to U.S. local exchange carriers. Thus, ICA's members are critically concerned with any proposal that affects a major component of the LEC's cost structure, as would the proposals set forth in the Notice.

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After carefully reviewing the initial comments submitted by carriers, regulators and other parties, ICA urges the Commission to:

1. Reject the more deregulatory options for depreciation represcription posed in the Notice. We believe that simplification of the depreciation process can evolve carefully over time. The cost of LEC compliance with current procedures is, in fact, quite small when compared to the possible adverse impact on ratepayers of even minor overstatements in LEC depreciation needs. Thus, any regulatory burden on carriers in the existing process can be phased down in a measured way.

2. Adopt the Basic Factors Range option, starting with the accounts that exhibit the most stable data and the least controversy. As we summarize below, ICA agrees with the majority of state public utility commissions that depreciation reforms must balance the needs of carriers, ratepayers and the needs of state regulators to have sufficient information to fulfill their regulatory obligations.

3. Extend the flexibility of ranges of basic depreciation input factors to the LECs' major plant accounts only after the Commission has determined whether existing depreciation accruals are being diverted away from reinvestment in the network. Studies underway for ICA suggest that LECs may be using depreciation rate increases simply to create funds for investment in other enterprises, rather than to upgrade and open their basic network infrastructure.

ICA agrees with most state regulators<sup>1/</sup> that should the FCC determine that a change is warranted in the current depreciation process, the Basic Factors Range Option appears to be the most reasonable and acceptable. ICA believes that it is imperative that the Commission not create conditions that could thwart adequate analyses of requested depreciation represcriptions. Filing requirement changes should not result in the use of depreciation rates that are not specifically applicable to the property to which the rates apply. The Basic Factor Range Option would allow the carriers to select their future net salvage (FNS), projection life, and survivor curve for each applicable account from within an established range. These basic factors would then be used to derive the parameters that determine the depreciation rate. The current process would be simplified because carriers might be able to avoid submitting detailed analyses to support these basic factors. Each carrier, however, should continue to maintain accurate property records and to analyze the information necessary to determine the depreciation expense appropriate for that carrier.

The other three options proposed in the Notice are not appropriate and should not be considered. Neither the Depreciation Rate Range Option or the Depreciation Schedule Option are reserve-sensitive, and therefore would not match allocation of expense with capital consumption. Under the Depreciation Rate Range Option, basic factors used to derive the parameters for the depreciation rate formula, such as life and salvage factors, would be ignored. Under the Depreciation Schedule Option, the Commission would establish a depreciation schedule for each plant account based on a Commission-specified average service life, retirement pattern and salvage value. Neither of these methods would be sensitive to the depreciation reserve position of individual carriers, which could be quite different from the "industry average," and under, or over recovery would occur.

The Price Cap Carrier Option affects only price cap carriers, and would allow them to file depreciation rates with no supporting data whatsoever. This method would not be in the public interest.

By leaving the choice of depreciation rates to the carriers, they



prescribed depreciation rates should serve as the initial basis for determining the ranges, and that the appropriate width of a range should be restricted to one standard deviation below and above the average. The ICA agrees.

In its Notice the Commission sought comments on whether carriers should be allowed to select any basic factor from a range, rather than permitting carriers a choice of parameters within the ranges (as the Washington and Wisconsin state commissions suggest). The ICA agrees with the Commission's recommendations to allow carriers to select their initial basic factors on the basis of the underlying currently-prescribed depreciation rates, plus a specific percentage of change. A consideration to be examined is how cash flow is utilized by the carrier; for instance, a company with a low reinvestment rate may be treated less rigorously.

The ICA agrees with most state regulators that the current accounting treatment afforded cost of removal and salvage should be examined in depth. The states suggest that these issues be examined in another phase of this docket. However, ICA believes that as it examines these technical accounting and depreciation issues, the Commission should not lose sight of the fundamental policy issue of what major LECs are doing with current depreciation accruals.

Today in the U.S., the major local telephone companies are complaining that regulators have set the rates of depreciation too low to provide the proper stimulus for network investment. The telephone companies have circulated a chart showing that telephone

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companies in other countries may depreciate similar plant and equipment at higher rates than U.S. telcos.

However, upon investigation one discovers that these telephone industry claims are very questionable. Studies underway for ICA suggest that LECs may be using depreciation rate increases to create funds for investment in other enterprises, rather than to upgrade and open their basic network infrastructure. A firm's re-investment ratio may be computed as the amount of total net income and depreciation of plant and equipment. These two funding sources make up the available net funds (ANF) for re-investment in telephone network (in addition to any new capital that is raised).

Table 1 (attached) shows that the RBOC re-investment rate has averaged only 64% during the years 1988-90, below the average U.S. rate of 70%. Because the Bell companies are so large, this reduced investment has a major impact on the U.S. average. Table 1 also shows that if the disinvestment condition of the RBOCs is removed from the data, the remaining U.S. reinvestment rate was quite high.<sup>3/</sup>

Table 2 shows that the U.S. appears to rank 19th in its rate of re-investment of ANF among the 25 major industrialized nations of the Organization of Economic Cooperation and Development (OECD). Many of the more developed nations competing with the U.S. re-invest all or nearly all of their reported ANF. If one generates

at the top of the list for these years. Telecommunications investment by non-RBOC providers has remained at steady and healthy levels even when some other telecommunications firms, such as the major long distance carriers, had to take major write-offs or operating losses due to competition in telecommunications markets outside the local exchange.

At the same time, the RBOCs were re-investing relatively low amounts of available funds in regulated operations, they continued to pay high dividends to their holding company parents. In some, cases, the dividend paid to the holding company significantly exceeded the dividends that the holding companies themselves paid out to shareholders. Additionally, some RBOCs have paid dividends to their parent in excess of earnings. This raises a significant policy question: Whether it is better to reduce consumer and business telephone rates (while still allowing LECs to raise new funds in capital markets), or to forego such rate decreases so that telephone companies can be milked like cash cows in order to support their parents entry into new businesses.

The conclusion of this analysis is clear. Before regulators increase the funds available to major telcos, either by depreciation rate changes or higher earnings, government policy makers deserve to know what is happening to the funds which are not re-invested in the U.S. local telephone network, and what the long-term consequences of these trends are?

For all of the reasons stated above, the International Communications Association respectfully asks the Commission to:

(a) Reject the more deregulatory options for depreciation represcription posed in the Notice; (b) Adopt the Basic Factors Range option starting with the accounts that exhibit the most stable data and the least controversy; and, (c) Extend these flexible depreciation ranges to the LECs major plant accounts only after the Commission has determined whether existing depreciation accruals are being diverted away from reinvestment in the network.

Respectfully Submitted,

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